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The diminished nation-state: A study in the loss of economic power

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Abstract:
"Globalization," or economic integration, and the ways it affects the economics and politics of nation-states are examined. Simple determinism is not in order because there are complex iterative processes at work.

Full Text:

THE PACE OF TECHNOLOGICAL CHANGE, especially the speeding up of communications, and the extent of international economic integration have, together, brought into question the effectiveness of many traditional, national economic policy instruments. The erosion of economic sovereignty has led many to question the future of the nation-state as the main building block of governance. This questioning has, in turn, affected the terms of debate of national politics. There has been, in many countries, a rise of populist movements rejecting closer international integration and some of its most visible symbols, such as trade and migrants. What is variously described as a "new nationalism," the "politics of cultural identity," the "politics of the soil," "positive nationalism," or the "new mercantilism" reflects, each in a different way, a reaction to the loss of authority of nation-states and an attempt to reassert it or to assert other forms of identity.

This essay deconstructs what is loosely called "globalization," or economic integration, and the ways it affects the economics and politics of nation-states. It argues that simple determinism is not in order. There are complex iterative processes at work. Domestic policy-making and politics have been internationalized and foreign policies have been subjected to growing domestic pressures. The nation-state has "lost" sovereignty to regional and global institutions and to markets but has also acquired new areas of control in order to promote "national competitiveness." While technological change may have pushed in one direction, social and political forces may have pulled in another. As a consequence, the extent and pace of globalization is much more in evidence in some areas, notably finance, than in others.

Overall, the process of globalization has generally been longer and slower than much contemporary conceit will admit. It has also been cyclical and subject to major reversals. Between 1914 and 1945 a combination of war and economic nationalism (the latter sustained until very recently in China, India, Russia, Argentina, Brazil, and Mexico, among others) reversed a century's progress in integrating economies. Although international trade has grown faster than output throughout the postwar period, the share of trade in the gross domestic product (GDP) of Organization for Economic Cooperation and Development (OECD) countries only returned to 1913 levels by around 1970, and for the United States by the late 1980s.(1) For many Latin American and Asian countries (and Australia) it is still much lower. Arguably the main achievement of the postwar international economic order has been to restore the degree of "globalization" to a level close to that which existed in 1913.

Many of today's global markets are, moreover, not a creation of our contemporaries but existed in similar, if not identical, forms long ago. The boom in the 1980s in the syndicated lending market strongly resembles the nineteenth-century cycles of lending, overlending, default, rescheduling, and fresh lending. And the current discovery of "emerging markets" by institutional investors is not fundamentally different from the nineteenth-century portfolio investment in the United States, Latin America, Asia, and Eastern Europe on behalf of British small savers. From the South Sea Bubble to the 1987 "crash," the international transmission of crises of confidence has been understood, at least by prudent investors. Many of today's big projects--like the Eurotunnel or the Hong Kong airport--have a high degree of global complexity but not significantly more than when the Panama and Suez canals were under construction. Today's transnational companies had recognizable forebears in the trading companies of centuries past.

Nor have the political arguments about the impact of globalization changed very much. Perhaps the oldest debate in economics is over the advantages and disadvantages of globalization in the form of free trade. The protectionist arguments put forward in France last year against the General Agreement on Tariffs and Trade (GATT) (the threat of "de localization"; the "unfairness" of "social dumping"; the need for "reciprocity"; the indispensability of agricultural subsidy and self-sufficiency) spring from mercantilist assumptions scarcely changed for centuries: arguments against which Adam Smith inveighed in The Wealth of Nations. As John Dunn has put it: "the fundamental antinomy between the Ricardian image of free world trade as a global public good and the more skeptical vision of trade as a worldwide battle ground, on which only the most manipulative and ruthless of state craft can effectively protect the national populations, goes back o the dawn of modern politics."(2)

This essay is concerned with the domestic political reactions to the intensification of globalization, which, historically, have fluctuated between adaptation, on the one hand, and rejection, on the other. Many people are bewildered by changes which seem: beyond their control. Such concerns have a long pedigree: "by the 1880s in Europe, conservatives saw in themes of ethnic purity and the concept of race a barrier against the onslaught of an increasingly complicating and fragmenting world and as a weapon for the assertion of identity on a wider stage."(3) Prejudices of this kind helped to cement some nation-states (Germany) and fragment others (Austria-Hungary) just as they help today to unify some societies (Japan) but divide many others.

Populist arguments about the disruptive effects of economic integration have a timeless quality which owes little to technology or advances in economic thinking. Mr. H. Ross Perot's antagonism toward Mexican low wage competition and Sir James Goldsmith's antagonism toward Asian competition in Europe(4) were never better expressed than in a seventeenth-century petition to Queen Anne to ban Indian textile imports: "English workmen could not compete with Eastern labour...(because) the people in India are such slaves as to work for less than a penny a day whereas ours there will not work for under a shilling."(5)

THE MECHANISMS OF INTERNATIONAL INTEGRATION

Technology and Global Economic Integration There are two main technological drivers behind globalization. First, and more sedate, transport costs have fallen with improved physical communications: better cars; jet aircraft; containerization; motorways. Second, and more spectacular, advances in computing power and in telecommunications--digital systems, satellite technology, and, more recently, fiber optics--have transformed the ease, speed, quantity, and quality of international information flows.

These changes affect economic activity in some specific ways. First, transactions and communications costs and times are falling rapidly. Many goods and services are becoming "tradable" that hitherto were not, and are therefore exposed to competition (i.e., perishable and seasonal fashion items; components of integrated production processes; "back office" accounts; and design work). Second, global communication systems make it possible for companies to coordinate efficiently across a wide range of countries their production planning and financial operations, and to run truly global operations. The concept of a global company is not new--the British East India Company and the early oil companies and plantation businesses were such--but many more companies can now operate globally to much greater advantage in a far wider range of activities. Third, information, per se, has become tradable: management consultancy; films, records, and compact discs; television news; telecommunications services; software systems, design, and programming. It is no coincidence that the Uruguay Round had some of its most testing moments over "information" issues that were scarcely thought of five years earlier: intellectual property protection, market access for films, and telecommunications. Fourth, capital has become highly mobile in the form of money, up to the point when it is converted into fixed assets.

Finance Capital: "The End of Geography"

Money is "an information product. The essence of money is...the information it conveys, whether as a store of value or medium of exchange."(6) Thus, Richard O'Brien begins his explanation of the ways in which computerization and advanced telecommunications (involving almost instantaneous linkages) have transformed international finance. There are now global markets for currency transactions and all forms of marketable securities. Competition is intense and capital is highly mobile.

However, technology alone cannot explain the process of financial market integration. This could only happen with the further step of financial deregulation: the removal of capital controls since the early 1970s; the removal of controls over interest rates; and the lifting of traditional barriers to entry into banking and other financial services. Liberalization policies and the globalization of finance made possible by new technology have powerfully reinforced each other.

Global financial markets have several major implications for the economic sovereignty of countries. Capital is now so mobile that markets will ensure that holders of financial assets receive roughly the same, risk adjusted, real return everywhere. Any country that offers significantly lower returns will experience capital outflow and a rapidly depreciating exchange rate. The recent fall in the dollar was not a product of speculative frenzy but a hardheaded calculation by financial institutions that they had too many dollars in their portfolio given the risk of higher inflation in an expanding US economy and the relatively unattractive returns on US Treasury paper. Any government that attempts an alternative, "reflationary" strategy and neglects these financial market fundamentals (as, say, the French Socialists did in 1980) risks a financial crisis. The sheer scale of profit-seeking finance capital that can be mobilized in currency markets far exceeds what any government, or even governments acting in concert, can put against it. Foreign exchange trading in the world's financial centers exceeds a trillion dollars a day, a multiple of fifty times, or more, of the daily amount of world trade and greater than the total stock of foreign exchange reserves held by all governments.

It is virtually impossible now to go back to exchange controls as an economic regulator. For economies whose financial markets are integrated into electronic networks, there is no "paper trail" for exchange controllers to follow; evasion would be massive, rapid, and largely unpunishable. Even those Latin American countries (or India or Russia) that have lacked a high degree of global integration, and yet endeavored to avoid adjustment in the 1980s, allowing their exchange rates to become overvalued, found that they experienced massive capital flight, which exchange controls could not stop. Various proposals have been made by Jacques Delors and others for taxing speculative transactions as a way of restoring greater stability of rates, but there is considerable skepticism among economic specialists as to their effectiveness.

The changes are profound. But how do they affect the fundamentals of economic sovereignty? Rather less, in fact, than a appears. Governments cannot fix their nominal exchange rates through exchange controls or expect to resist strong movements by using reserves. But they can manage the rate by using interest rates if they are willing to subordinate monetary policy to this end. For those governments that choose to peg their currencies externally--the members of the European Monetary System (EMS); countries like Hon Kong, Poland, Czechia, or Estonia, which have a dollar or deutsche mark peg--the policy regime they follow is much like that of the gold standard in the nineteenth century, without gold. Late nineteenth-century Britain, the economic hegemon of the period, accepted the surrender of economic sovereignty implicit in the gold standard: that any unsustainable deficit on trade would produce a gold outflow and an automatic contraction in money supply and recession. Modern foreign exchange markets will more quickly overwhelm any government with a lapse of policy discipline but the principles are essentially the same.

For those governments hat elect to pursue an independent monetary policy--the United States, the United Kingdom, Japan, Brazil, and Russia, among others--the option of monetary independence remains. What these governments are, in effect, doing is choosing their own rate of inflation; having done so they then largely surrender exchange rate determination to the foreign exchange markets. The markets will balance the returns in different currency assets, taking account of real interest rate differentials and exchange rate risk. What is different in today's financially globalized world, compared with earlier experience with floating exchange rates, is that trade no longer matters very much in extern rate determination because of the sheer weight of capital flows. So a country can run a current account deficit for long periods, like the United States has.

Further reflection may suggest that the area of discretion left to national governments is not as great as it appears. Governments may well decide to exercise their sovereign control over the printing presses, but while it is possible, even in a globalized world, to have an economic policy as distinctive as that of Ukraine or Serbia, or Greece within the European Union (EU), its durability must be in some doubt since the advantages of "independence" are not at all obvious. Many governments have rationalized their role in a financially interdependent world in an opposite sense; even that most nationalistic of countries, France, has consciously opted to have its monetary policies, in effect, determined by the German Bundesbank.

Foreign currency markets are but one of the dimensions of global financial market integration, though by far the largest in terms of turnover and implications for national policy. International, cross-border bank lending also grew twice as fast as world trade in the last three decades. With the advent of the debt crisis, securities markets grew vigorously, replacing bank lending in importance; cross-border equity related securities increased from $200 million to $20 billion in five years (1983-1987) and the stock of international securities quadrupled to $19.5 trillion in 1988 from the 1982 figure.(7) The last few years have seen comparable growth in portfolio investment in emerging markets and in cross-border dealings in financial innovations like derivatives.

All of this has a complex effect on nation-states: individuals and companies (and governments) have more access to cheaper finance; but individual countries are more exposed to internationally transmitted shocks and national regulators have been obliged to cede control to global markets that are wholly unregulated (currency markets), lightly self-regulated (bond markets), or imperfectly regulated (as with multinational banking, whose imperfections were exposed by the BCCI scandal).

Foreign Direct Investment and Multinationals

A second driving force in the globalization process has been the rapid growth of direct foreign investment through transnational corporations (TNCs). As explained earlier, this is a phenomenon that is by no means new; by 1913 there were not only the early trading operations of the East India and Hudson Bay Companies but TNCs that were the direct ancestors of today's industrial companies: mainly British and American industrial companies that invested a significant part of their assets in, for example, textiles, food, chemicals, and engineering production abroad. The process continued in the interwar period, though disrupted, like trade, by the economic nationalism and instability of that time. (One estimate, admittedly crude, is that the stock of world foreign direct investment fell from around 9 percent of the global GDP in 1913 to less than half of that figure and had not recovered its earlier importance, even by 1990.)(8) Nonetheless, helped by advances in communications and (outside of the developing world) by liberal economic policies, the postwar period has seen a considerable expansion. A large and increasing proportion of international trade derives from this overseas investment, and trade is consequently intrafirm rather than international (estimated at over SO percent of the international trade of both the United States and Japan and 80 percent of British manufactured exports).(9)

The rapid growth of TNCs as a force in the world economy has been discussed for so long as to have become a cliche. There have been, however, within the last decade, some major changes that have perhaps changed the nature as well as the scale of direct foreign investment (and certainly underline its complexity and variety). First, some companies have moved beyond the stage of having subsidiaries in a variety of markets (what have been called "multidomestic" companies) to becoming, globally integrated, exploiting advantages of communications technologies and flexible production methods to achieve major economies of scope and coordination, as well as scale. An example is the recent change in the Ford Motor Company's strategy to produce "global" cars from its several European and American operations.

Second, there was, after the mid-1980s, an explosive growth of foreign direct investment (FDI)--by roughly 400 percent over six years--far greater than previous growth and three times faster than the growth of trade.(10) Most of this capital was invested among the "triad" of the United States, Japan, and the European Community (EC). Much was in the service sector involving the integration of banking and other services into the global economy.

Third, within the last few years, after decades of stagnation, there have been signs of a very large inflow of FDI into non-OECD countries, brought about by the opening up of countries like China, India, Mexico, Russia, Hungary, Brazil, and Argentina. Since many of these markets are actually or potentially very dynamic and cost differentials from traditional locations are large, future flows could be huge.

How does the growth of FDI affect the economic sovereignty of nation-states? There are several possibilities. First, the sense of identity associated with "national" companies and the loyalties flowing from that identity are disappearing. Companies that a few years ago were nationalized United Kingdom public utilities--British Gas, British Telecom, British Airways--are now global companies with increasingly tenuous connections with Britain. What used to be called British Leyland, the "national" car company, disappeared successively into a partnership with Honda and ownership by BMW. In Britain (like Canada, Australia, Holland, Singapore, and Argentina) the national origin of the owners of leading companies may no longer be a very controversial issue, though elsewhere (France, Korea, Japan, India, and, to a degree, the United States) it is immensely sensitive and cuts into the heart of the issue of what nation-states exist for.

The idea of multinational companies as "stateless" has been given impetus by the claims of Robert Reich and others that companies not only relocate production to maximize global economies of scale and minimize costs but also relocate "research, design, and development" facilities and company headquarters, too, in "global networks."(11) Recent research, however, has cast serious doubts on this assertion: US companies are shown to conduct no more than

percent of their technological activity abroad, and while there is a higher proportion in Europe, it seems not to be increasing.(12)

The question of identity is also less clear-cut than the rhetoric about globalization often suggests. Analysis of the attitudes and behavior of executives suggests considerable differences in the "cultures of capitalism," which, even within the highly integrated European market, have made successful cross-border corporate mergers exceedingly rare.(13) There may be a few British, Dutch, Swiss, or Belgian companies that have begun to create a genuine sense of

global identity but most multinationals clearly reflect the ethos of their home country management and shareholders. Moreover, many "global" companies are less global than they seem to be or claim to be. Ford, for example, has 80 percent of its fixed assets still in the United States; McDonald's and Pepsi still have a majority of fixed assets at home. Nonetheless, it may be only a matter of time before the buildup of overseas assets, professional recruitment in international markets, and global networking within companies transforms the culture of companies into something that is no longer "national."

Second, the dominance of TNCs in trade flows has changed the meaning of "exports" and "imports." Are US "exports" simply the goods and services that pass across US borders or do they include the production of US subsidiaries in Canada, Mexico, and Europe and/or the sales to Japanese subsidiaries in the United States?(14) In a wholly integrated, globalized world such issues would not be of great concern (who worries about the magnitude of Minnesota's exports or the Anglo-Scottish trade balance?) but in a world where national governments retain some policy discretion and people care about national economic "success," they have to be addressed. If they were adequately addressed, it would be increasingly clear that the conventional benchmarks are useless; the United States, for example, runs a large "surplus" on trade if the operations of US companies abroad are taken into account. But the point has yet to register with many national trade officials who are preoccupied with bilateral deficits.

Third, the mobility of capital and the importance of FDI have subtly changed the nature of national economic policy. Governments have long worried about "national competitiveness," by which they have usually meant the competitiveness of exports and import competing activities. In countries with a mercantilist tradition this concern has expressed itself in the idea that exports should be promoted and imports discouraged. The idea that exports should be promoted as a symbol of national success is still a powerful one and finds expression in export credit competition and statesmen traveling around the world as salesmen for their countries' products. Yet, "competitiveness" is no longer predominantly a trade issue. Rather, it is about creating the right business conditions--infrastructure, deregulation of markets, skilled and educated labor, financial stability--to attract or retain mobile capital. The Porter concept of "competing nations"(15) captures the spirit of the new agenda, already being developed in small open economies like Singapore (and not-so-small countries like Britain).

Trade in Goods and Services

I suggested earlier that the globalization of trade is less spectacular and less secure than in relation to capital flows. World trade has grown more rapidly than global output in the postwar period (6 percent as against 3 percent in the 1960-1990 period) though much of this growth is specifically attributable to the dynamic export performance of East Asia and the integration of Western Europe. The limits of globalization can clearly be seen in the United States, which, despite openness in many respects, exports only just over 10 percent of its GDP. Many countries have resisted trade liberalization or have been marginalized from it. In some sectors--agriculture, textiles, steel--trade is planned and regulated in the industrialized West to a degree that would not have been out of place in the Communist bloc. And the extraordinary intensity of resistance to rather modest trade liberalization underlines the stumbling blocks to further opening.

Nonetheless, there are changes in the trade field of a qualitative kind which are having a serious effect on economic sovereignty. First, a substantial segment of trade is now intra-industry rather than interindustry, often due to specialization within TNCs. Traditional factor-based "comparative advantage" is now an inadequate explanation of patterns of trade; arguably a more important factor is the internal logic of specialization within TNCs, as already described above. There are now large parts of the economy where it is no longer possible meaningfully to disentangle "national" exports and "foreign" imports for trade policy purposes (one reason why protectionist rhetoric often cannot be translated into action and why, for example, it is scarcely conceivable that large scale trade warfare would erupt among members of the EU or between the United States and Canada).

Second, one area of trade which is growing very rapidly is in services which penetrate much deeper into national societies than a movement of goods. This phenomenon partly reflects the growth of services which underpin the globalization process itself: more foreign earnings or expenditure from air travel and shipping, cross-border insurance business, and the spread of multinational banking. It also extends international competition into areas hitherto safely (if inefficiently) nontradable: engineering, legal, and accountancy services; retailing (as with the advance of Seven-Eleven and Blockbuster Video throughout Europe); and nursing and cleaning services. Most serious in terms of social and political impact is the opening up of telecommunications and multimedia services to international competition. It was no coincidence that in the closing stages of the Uruguay Round, Jack Valenti, representing Hollywood, was one of the most influential US lobbyists: Hollywood and Cable Network News are arguably now more important in trade than General Motors or United States Steel; the British music industry "exports" more than the aerospace industry. These are not just amusing factoids; they illustrate a new dimension of globalization through trade: traded services that can mold cultural values and provide information through news, entertainment, and advertising, and which also cut to the heart of nations' senses of identity.

Third, as economies become more deeply integrated through trade as well as investment, the traditional, explicit barriers to trade disappear (which they mostly have for manufactures). Obstacles to trade are becoming more opaque and stem from practices hitherto regarded as the preserve of the nation-state. Thus, Japanese consumers' conservative preference for buying Japanese and the inefficient Japanese retail system have become "hidden barriers to trade" The Japanese-United States bilateral trade negotiations (the SII) have dealt with reform of the United States education system, the adoption by the United States of metrication, and improving United States savings behavior (since all, indirectly, would help rectify the United States' external imbalance).

A further dimension to the deepening of integration between countries is the attempt at global, or regional, harmonization of standards. Different technical, environmental, and consumer product standards can be an obstacle to trade. Car exhaust emission standards have been used to block car imports. Even where standards are not a deliberate trade barrier, a profusion of national practices fragments global and regional markets and usually puts foreigners at a disadvantage. One solution is to harmonize standards. This has been tried in the EU but it has run into problems both of complexity and absurdity (trying to make all Europe's cucumbers straight). A softer "mutual recognition" approach has been adopted and used also in GATT (as, for example, in the mutual recognition of professional standards in the EU's Single Market and the GATT's agreement on product standards). But this leads to complaints that "mutual recognition" in the interests of free trade leads to a "dive to the bottom," particularly in areas like environmental and social standards, where producers in one country may derive a competitive advantage from tolerating lower standards. This has in turn led to pressure for "minimum" standards. Poorer countries argue--and with great justice--that they are then forced to adopt higher standards than is appropriate for their level of development and amount to a form of disguised protectionism. The rights and wrongs of the matter are not relevant for discussion here, merely the observation that trade policy is increasingly about aspects of national life that were hitherto purely "domestic."

Trade policy has also become the battleground for those trying to spread what they see as universal values, since trade makes differences in values transparent and is also a way of gaining leverage over other countries. Thus, trade policy has become intertwined with environmental preferences (restricting dolphin-unfriendly Mexican tuna and trade in tropical timber); human rights (China); animal rights (trade in tropical birds; sealskins; whales; furs); and labor standards. Within the North American Free Trade Agreement (NAFTA) and the EU and in the GATT, environmental and social policies are becoming the subject of international negotiations. The economic basis of harmonization in many of these areas is very questionable since they fail to respect genuine differences of wealth and taste and involve creating impediments to trade when more appropriate remedies are available. But it is an unsurprising consequence of high levels of interdependence that citizens of one country are trying to influence policy elsewhere since it affects the terms of competition and because, as fellow global citizens, they want to interfere.

Thus, as trade and foreign investment become interwoven, international trade negotiations increasingly move into other areas of national economic policy hitherto seen as of exclusively domestic concern. As governments face this mounting list of demands to change their national practices, they are in a bind: either they allow foreigners to negotiate over what Mrs. Thatcher called "the nooks and crannies of national life' or else tensions (or "systems frictions") build up between trading partners employing different rules and conventions.

Movement of People

One respect in which globalization was more advanced in earlier generations than today was in the acceptance of large numbers of migrant workers. The magnitude of intercontinental migration by the European "huddled masses" to the United States (or Canada, Australia, Argentina, Brazil) in the period from 1880 to 1913--an annual average of 600 thousand to 1.5 million people(16)--was arguably a far greater proportion of the population of host or originating countries than migration from poor to rich countries today. Countries that were major exporters of people in generations past--like China or India--no longer are (or are able to be). The decline in the importance of mass migration as a global phenomenon (except for--usually temporary--cross-border refugee movements) is even more striking when we consider that the potential for migration, as represented by the difference in living standards and life opportunities between rich and poor countries, is now so much greater than. a century ago. Some argue that the differentials are so great that the market forces represented by migration will burst through the controls much as drugs already have. The smuggling of people from Mexico and China (and from Haiti and Central America) to the United States, the increase in "asylum seekers" in Germany, and the semi-official South Asian migration to Japan may suggest that strict control is difficult. The trend, however, is to strengthen restrictions, and this is reflected in international negotiations (NAFTA has been followed by a tightening, not a relaxation, of cross-border movement; the GATT services negotiations mostly excluded free trade in services that involve labor migration).

Controls over migration (to the extent that they are successful) could be said to represent a powerful brake by the nation-state on globalizing forces. Two important qualifications, however, need to be made. First, despite severe control, some migration has taken place, which has created, legally or illegally, significant and distinctive immigrant minorities in countries where they did not previously exist (Germany, Scandinavia, France, the Gulf states--even Japan) or changed the composition of countries which, while immigrant receiving, did not have today's ethnic diversity (Australia, Canada, the United States). Second, the restrictions apply overwhelmingly to the unskilled and unqualified; those with money or useful professional qualifications are much less restricted (moreover, business travel and international tourism have created opportunities for mobility among this group that are not widely shared). What Robert Reich calls the "symbolic analysts" or "elites" are part of a globalized, increasingly denationalized environment while their fellow citizens are cut off from it. This differential behavior is bound to have significance for the way nation-states are seen and function.

Globalization and Global Policy Regimes

Globalization is largely private sector driven. It represents, therefore, a shift in the locus of decision-making not only from the nation-state to transnational actors but also from national governments to the private sector. For this reason, economic liberalization and globalization have often gone hand in hand, as with financial sector deregulation, foreign exchange decontrol, and freedom of trade.

There is, however, one factor pulling in the opposite direction. As the global system becomes more integrated, there is a demand for international public goods that neither markets nor nation-states will provide and (positive or negative) externalities that they cannot capture. These international public goods are roughly summarized as follows: systemic financial stability; the rule of law and dispute settlement needed for an open system of trade and investment; common standards for weights, measures, and interconnection; management of global communications networks like aviation, telecommunications, and sea-lanes to prevent congestion and disasters; management of environmental concerns like Autartica, the atmosphere, and oceans (and to stop cross-border pollution as with acid rain and sewage dumping in shared seas like the North Sea).(17)

All of these require some form of institutional development beyond the nation-state. Some of these activities are largely self-regulating, since the main commercial users have a collective interest in providing for the public good, as is the case with bond markets (International Securities Markets Association) and many industrial standards (the International Standards Organization [ISO]). In some cases, semiautonomous national constitutions provide the institutional cement (Central Banks in the Bank of International Settlements). In some cases, there is mixed public/private sector participation, as in the International Telecommunications Unions. But, mostly, there is sovereignty pooling by governments through new institutions (the EU; the World Meteorological Organization) and treaty obligations (the Antarctic Treaty; the Montreal Protocol). There is a complex but rich system of governance growing up to manage globalization (summarized in Figure 1)(Figure 1 omitted). It is a moot point as to whether this aspect of globalization detracts from the sovereignty of nation-states or maintains (or enlarges) it.

THE NATION-STATE: WHAT IS LEFT?

Remaining Areas of Discretion

It is tempting to conclude that economic globalization has made the traditional nation-state redundant. The truth is much messier. This is partly because nation-states differ enormously in scale; in the United States, China, or India the narrowing of policy options as a result of global economic forces is much less obvious than in Holland or the Philippines, let alone in Tuvalu or Luxembourg. The messiness occurs also because there are some areas within which national governments retain substantial areas of discretion and others where they are pooling sovereignty to manage the globalization process. National economic sovereignty is being eroded, slowly and differentially, not eliminated.

The first and most obvious area of control, as noted above, is inward migration. In the EU, there has been a liberalization of internal migration to create a true Common Market but it has been matched by a commitment to clamp down on non-EU immigration. There has been a joint commitment that restrictions "should be maintained and where necessary strengthened." Despite some leakage through illegal entry and asylum seeking, there is little doubt that where governments resolve to curb immigration singly or (as in the EU) jointly, they can do so. The position in the United States is less clear because the political debate about the relative merits and demerits of immigration is unresolved, though the 1994 Congressional elections suggested that there is a powerful mood for tighter restrictions.

The significance of migration control in an increasingly interdependent world economy is that it provides governments in relatively high wage economies with one instrument to protect the real wages of some segments of native labor from external competition, particularly in nontraded services. It also protects their "identity." This is now becoming one of the most important residual functions of the nation-state, primarily of value to high income states (arguably, immigration controls are economically damaging to the restricting country, but we are concerned here with political perceptions).

Second, despite the general trend towards liberalization in trade, major areas remain where national trade policy action is still strong: where there are powerful coalitions of workers and national businesses, notably in agriculture, steel, and textiles; where there is active use of "anti-dumping" measures to restrict "unfair," "low cost" competition, a practice which appears to be growing in the United States and the EC despite some multilateral disciplines; and, under the banner of "strategic trade policy," where favored new industries are promoted through subsidies and government procurement. Also, the reemergence of crude trade bilateralism--as in the United States and Japan trade dispute--is another sign of the tenacity of mercantilist thinking and policy-making. After the desperate efforts required to bring the Uruguay Round to a conclusion, it would be heroically optimistic to say that globalization has displaced the mercantilist trade policy-making behavior of nation-states.

Even in the much more liberal environment of capital movements, the nation-state retains substantial areas of discretion. In some countries, inward investment is still very small and access difficult, most obviously in Japan, Korea, and India. Even in Germany and Switzerland, entry by takeovers is extremely difficult because of distinctive national systems of corporate governance. And even where governments cannot or do not wish to control capital flows directly, they can manipulate them indirectly: for example, in the case of direct investment through investment promotion and tax and incentive regimes.

Subsidiarity

The question of what nation-states can or should do in the face of globalizing influences has expressed itself in Europe in the form of a debate about "subsidiarity." The subsidiarity principle, which derives from old arguments about the scope of federalism at the time of the drafting of the United States Constitution, is that action should be taken at the lowest level at which it is efficient; in economists' terms, nation-states (or subnational units) should do those things which do not create "externalities" for their partners in economic integration, global or regional.

The problem is that the subsidiarity principle does not give clear-cut answers. Labor standards and social policy are preeminently national matters, but, increasingly, there is pressure to "globalize" these issues through harmonization in order to prevent what is seen as competitive undercutting. Tax should be a national or local matter, but where there is competition to attract investment through lower business and income tax rates, tax bases can be eroded. Public spending preferences should be a national or local matter, but they become international through public procurement involving tradable goods and services. Monetary policy is national, but one government's actions affect another's, and in Europe there is a growing recognition that, among neighbors at least, monetary independence is an expensive luxury.

Governments are increasingly under stress, facing demands for action by their citizens but externally constrained. The stress shows itself in two main ways. As nation-states gradually lose control over economic forces in some areas, they try to "nationalize" those activities they potentially can control. Thus, in trade policy, governments have been forced to accept the logic of tightening multilateral disciplines, but, as with the United States Super 301, politicians simultaneously strive to invent new ways of pushing national discretion to its limits. The Reagan and Thatcher administrations did much to open their respective economies to external influences by stripping away regulatory controls affecting capital movements and trade, but the Reagan administration fiercely resisted pressures from elsewhere in the Group of Seven (G7) to curb its budget deficit, and Mrs. Thatcher fought hard (with mixed success) against Britain being constrained in its economic policy by the EMS. There is, thus, an underlying tension and contradiction in the policies of most governments: embracing certain aspects of globalization and loss of sovereignty while resisting others in the name of the sovereignty of the nation-state.

The tension also appears in another way. Governments are under growing pressure to do more for their citizens to help them adjust to changes brought about in part by intensifying international competition: meeting the costs of structural unemployment and of educating the next generation to a higher level; creating higher standards of infrastructure and environment. To meet these costs, the state in most Western countries is generally taking a larger share of the GDP (after fifteen years of the Thatcherite "revolution" in Britain and the privatization of almost all nationalized industries and utilities, the government share of the GDP--40 percent--is actually larger than when it took over from a Socialist administration!). Yet the tax burden to support social safety nets is self a determinant of competitiveness. One consequence of the mismatch between what governments are expected to provide and what the tax base can support is the emergence, almost everywhere, of structural public sector deficits. One of the remaining privileges of the nation-state is the scope it provides for independent fiscal policy and deficit financing, but even this activity is eventually circumscribed by international financial markets: which foreign investors are willing to lend and on what terms.

Equity and Distribution

One of the most crucial functions that nation-states still perform, and are expected by their electorates to perform, is maintaining a sense of "fairness" in the distribution of opportunities, income, and wealth (the mix of concerns varies from country to country). What makes the very open Nordic economies distinctive is their particular Scandinavian concern with egalitarianism. Fiscal policy--taxing and spending--is the main redistributive instrument of the nation-state. Globalization is, however, making the task more difficult.

The difficulty arises from two sources. First, some factors of production are mobile: capital wholly so, professional and skilled labor partly so. Since firms and investors will try to maximize their risk adjusted, post-tax rates of return on capital, countries that have abnormally high or low rates of business tax will lose or attract capital. The same applies to higher income personal tax rates. Consequently, there has been a convergence around lower corporate and higher band income tax rates in many countries. Governments are, then, forced back onto indirect taxes as a revenue source, which tends to be regressive in character.

The second difficulty, in rich countries, arises from the "factor price equalization" process whereby trade and/or migration between countries. with different availability of labor can have the effect of pushing up the relative returns to capital and pushing down the relative returns to labor (particularly unskilled labor) in the (rich) country. This could partly explain the stagnation in real wages and the widening income inequality within the United States in the 1980s, though there is much controversy on this point.(18) This is in addition to those who suffer injury from international competition (the injury is often exaggerated but nonetheless real).

Governments may, therefore, be faced with great difficulty in meeting domestic expectations of "fairness." Some will try to deal with the problem by deflating expectations about governments' redistributative role (the Thatcher, Reagan approach). Others try to achieve redistributive objectives through some form of protectionist device (European agricultural policies is a classic example, but one which also highlights the expense and ultimate futility of such methods). A major challenge governments will face is how to maintain a domestic consensus on "fair" income distribution, when they seem to have declining room for maneuver because of external constraints.

THE POLITICAL REACTION TO ECONOMIC GLOBALIZATION

The changes represented by global economic integration have implications for domestic politics and the balance of forces within states. The most obvious consequence of globalization is that forces of international competition, and the mixture of opportunity and personal risk that they represent, affect a widening spectrum of the population. Not just steel and textile workers, but bank clerks, journalists, creative artists, shopkeepers, employees of public utilities, and doctors operate increasingly in a global as well as a local marketplace. This breaking down of established borders is, and always has been, part of the dynamics of capitalism. Anthony Giddens has described how it is the nature of the Western world to create new risks as a result of bringing communities into closer contact.(19) But these risk-generating linkages, and the associated insecurity, are occurring largely in a political vacuum caused by the decline of traditional "Left-Right" politics.

Global integration has specifically affected the positions of organized labor and the sense of working class solidarity, which have been the mainstay of left-wing parties in the developed world. Labor, unlike capital, is largely immobile. As Susan Strange puts it, "the reshuffling of the pack in the production structure has affected class relations more directly than it has affected international relations....[T]he fact that a transnational company can move its plant...while a worker can not move to another country has robbed labour unions in industrialised countries of their power...."(20) We have already noted that globalization may be squeezing the wages and job prospects of the more unskilled workers in rich countries in particular. At the same time, for the educated and moneyed section of the population, the opportunities presented by globalization--travel, wider experience, promotion--are great. We thus have one, potentially large, disadvantaged, alienated, and powerless element in society and another which is flourishing but has less of a stake in the success of any particular country.

Such tendencies might lead to a loss of authority of those who govern in the name of the nation-state. Jurgen Habermans writes of a double crisis, of "rationality," where the state cannot protect its citizens in ways they have been used to expect, and a crisis of "legitimation," where the state cannot any longer rely on the loyalty of its citizens.(21) Matthew Horsman and Andrew Marshall describe the consequences: "Fragmentation and integration have undercut traditional affiliations....[T]hey are also weakening political elites, compromising their power to reallocate resources and to promote stability....But atomization has not altogether destroyed the sense of allegiances citizens feel....It has displaced it, shifting all previous to different levels...based on perceived commonalities of ethnic background, religion and language."(22) There is, thus, a chain of cause and effect which links economic globalizing forces to contemporary expressions of "tribalism" or "cultural identity."

A Politics of Identity

The preceding argument can be expressed in another way to suggest that what may be happening politically is not just a set of isolated, if interesting, events but is nothing less than the emergence of a new "organizing principle": a reorganization of political loyalties on a fundamentally different basis.(23)

For many societies, and certainly those of the Western world, the traditional political organizing principle has been a dichotomy between "Left" and "Right," reflecting different views about equality and class loyalties and about the respective roles of state versus private ownership and public versus private spending. These controversies have not disappeared, but they have lost much of their intensity. The collapse of communism and, more generally, the intellectual retreat of socialism have greatly narrowed the area of debate. As a consequence, old parties of the "Right" or "Left" have been swept away (Italy, Canada) or, more commonly, have retained their outward form but adopted policy positions that are scarcely distinguishable from their rivals (the shift of French, Spanish, British, and Brazilian Socialists to "social democracy" and the switch of Italian, Polish, and Hungarian Communists to moderate reformism) or, in some cases (Australia, New Zealand, Argentina), are ever more zealously market. oriented than the "right-wing" parties.

At the same time, powerful new parties and movements within parties have emerged or reemerged almost everywhere asserting some form of cultural identity. The specific focus may be different: language (Canada, Belgium, Spain, India, Hungary, and the former Soviet Union); religion (Algeria, Turkey, Egypt, Pakistan, Palestine, India again, Nigeria, the "Christian coalition" in the United States, Ireland, and confessional nationalism in the former Yugoslavia); race (the National Front in France, South Africa, Malaysia, Rwanda); caste (India); or other forms of "regional" identity cutting across nation-states (Scotland, Lombardy). These can be treated as a pastiche of different political phenomena or, alternatively, as representing one pole of a new type of political dialectic. One extreme is the expression, politically, of a unique, exclusive identity; the other is a more liberal, eclectic, inclusive approach, characterized above all by what can be described as an emerging sense of "multiple identity" within which people (and parties) reconcile the various claims on them in the increasingly complex, blurred world of globalization. (See Figure 2.)(Figure 2 omitted)

Where the politics of identity is powerful, it has redefined the political agenda (Figure 3).(Figure 3 omitted) Many of the new concerns center on the role of the nation-stare and national identity in terms of responses to globalization. In France there is some restrained Left-Right argument about privatization, inequality, and labor rights, but much greater passion has been generated by the Maastricht Treaty, GATT, and immigration. The politics of the United States is heavily influenced by nationalism (in relation to trade and migration) and by religion. There is no strong correlation with traditional "Left-Right" divisions. Protectionism is being advocated by the democratic "Left" and the republican "Right" and by Perot supporters who do not match the old classification at all. The interweaving of issues is obviously complex, but the changing nature of domestic politics is focusing attention onto the question, "what are nation-states for" and what do they do in a world where governments face considerable external constraints on their freedom of action Ironically, one of the answers to the apparent weakening of the economic sovereignty of nation-states may be a reassertion of economic nationalism in new forms.

New Forms of Nationalism

Nation-states are under pressure from within and from without. Yet, except in a few rather special cases (the Soviet Union, Ethiopia, Czechoslovakia, and Yugoslavia--all formerly communist dictatorships, and the first two empires) the nation-state is still with us and seems likely to be around for a while. Even such improbable conglomerations as India, Indonesia, Canada, and Nigeria manage to hang together. Central to their survival will be the ability to carve out a role that is compatible with both the forces of global economic integration and the internal strains created by the politics of identity. This means emphasizing what Anthony Smith calls the "Western" model of nationalism based on common laws and institutions, a mass civic culture and territory as against "Eastern," ethically based nationalism.(24) Various survival strategies are apparent.

Defensive Nationalism. The behavior of the French-Balladur administration in relation to the GATT was more than just a defense of influential vested interests--the farmers and the media. It was a strong reassertion of French identity. The defense by the Japanese and the Koreans of their rice economy had similar inspiration and effect. India has a growing swadeshi (self-reliance) movement organized by the "right-wing" Hindu opposition BJP, as well as nervous Indian businessmen fearful that competition means being bought out by foreigners. Even leaders with strong liberal credentials--Salinas in Mexico or Yeltsin in Russia--have dug in their heels to protect what is seen as the "national patrimony," represented, for example, by the energy sector.

However, defensive nationalism is not, in itself, an adequate strategy. If it is taken too seriously there is the risk of isolating the country from the mainstream of globalization or creating unsustainable demands for protection and budgetary support from uncompetitive sectors (the Burmese or Ukrainian road to ruin). If, on the other hand, it is merely symbolic and ineffective, the state will have undermined its own credibility (the Slovakian "divorce" was premised on a belief in the potential for defensive economic nationalism that has not been achievable, seriously eroding the legitimacy and cohesion of the new state).

"Positive Nationalism." The idea of "positive nationalism" essentially tries to recast in modern idiom the old mercantilist philosophy that imports (goods, capital, people) are bad, but exports are good. The postwar experiences of Japan and Korea have lent some credibility to the idea that it is possible to be mercantilist in an outward looking and economically successful way; that globalization can be controlled by "national" companies for national ends; and that wise governments can steer resources to enhance long-term growth. Some of this thinking is prevalent in many countries (the "Korean model" is frequently cited as an example in many developing countries, Japan in the rich world). There are also elements in the United States: the belief in "strategic trade policy" and the use of unilateral trade measures to pressure trading partners into making market opening concessions. The idea of a head-to-head confrontation between the United States, Japan, and the EU fits comfortably with this view of the world.(25)

"Positive nationalism" has, however, several fundamental weaknesses in an era of globalization. First, it presupposes that it is possible to define economic activity in national interest terms, when in reality growing numbers of companies are operating as global firms and consumers do not have the same interests as favored producers. Second, it assumes that governments are good at being "positive," when experience shows that bureaucratic and political imperatives often prevail. Third, treating global economic activity essentially as a zero-sum game can lead both to interstate friction and to a neglect of global rules without which globalization cannot work effectively.

The "Competing Nation. " A subtly different version of "positive nationalism" recognizes that capital is mobile, that companies are increasingly global, that governments have little talent for "picking winners," and that competition occurs, essentially, between companies rather than countries. Nonetheless, a sense of national economic purpose can be created around the idea of "competitiveness": creating a pool of highly educated and flexible workers, an efficient infrastructure, sound money, and a good quality of life. Such a "competing nation" is then well placed to operate as an open economy, attracting mobile financial and human capital. At the same time, some areas of discretion are still open to governments--migration control for example. This is the "Singapore model," now being intentionally or unconsciously adopted by large numbers of small states, others which are not so small (Britain is a major country trying to position itself to be as attractive as possible to foreign investors), and some of the reforming economies of Eastern Europe, like Hungary and Czechia.

A difficult balancing act for governments following this paradigm is to generate a strong sense of national cohesion and purpose while operating within the constraints of global (or regional) rules and accepting the verdict of global markets. There is a twofold response to this dilemma. One is symbolic nationalism, squeezing maximum political advantage from events that have a patriotic appeal but do not interfere with a strategy of openness: fighting the Argentines; flogging American teenagers; sporting prowess. The second response is an insistence on "subsidiarity": not countenancing encroachments on sovereignty (especially those that affect "competitiveness") that go beyond what is strictly necessary for efficient integration (e.g., Britain and the European "Social Charter"). But this approach requires a sensitivity and an ability to respond to external pressures that owes much to country size and traditions.

Federalism. Another approach for small and medium-sized countries is to try to recreate a sense of national identity and cohesion through larger units. The Zollverein, the German customs union, which formed the economic platform for the German nation-state, has been seen, at least by some Europeans, as a role model for the future EU. Certainly for European "federalists," the goal of a United States of Europe has been a guiding vision. It is also progressively being realized, the Maastricht Treaty being the latest step. The vision is one which subsumes the antagonistic nationalism of old, not so much in global disciplines but in a kind of supernational state.

It is possible in the very long term to envisage a world of large entities, "supernations"--the United States, the EU, Russia, Greater China, India, Brazil--which capture many of the economies of scale and scope that globalization offers and manage to create an overarching sense of "national" identity to encompass many nationalisms within a federal structure. One problem, however, is that even the largest nation-states are having to respond to globalization by opening their economies to trade and foreign investment (as China, Russia, and India are all doing) or by building yet bigger structures (the United States and NAFTA; a recreated Soviet Union). And, as the EU is discovering through its enlargement, the bigger the structure the smaller the sense of identity: hence the "deepening" versus "widening" debate. There is, moreover, a danger of regional "blocs" becoming a platform for new forms of exclusive nationalism, which undermine globalization and lay the basis for conflict. The Zollverein is not an altogether cheering precedent in this regard.

Another, and perhaps complementary, development is the growth of subnational identities within federal structures. Many of the roles of the "competing nation"--facilitating capital inflows; setting tax and public expenditure priorities-can be dealt with at the level of Wales rather than Britain, California rather than the United States, Quebec rather than Canada. Indeed, the move to larger units gives the new "nationalisms"--of Scotland, the Italian and Spanish regions, Flanders, and Wallonia--space to operate within a loose European federal structure (which is why Scottish Nationalists and the Lombard Lega favor the vision of EU federation). In China, much economic decision-making is now devolved at the level of the province and city. In India, central government is delegating a wider range of investment promotion, regulatory, and fiscal powers to the states. The new South African government has transferred much of its economic decision-making role to regional assemblies. The latest Brazilian constitution is highly federalist. In these cases, there is a recognition that multilayered forms of identity and responsibility have to be created around (above and below) the nation-state.

CONCLUSION

The phenomenon of globalization has led to a reduction of the room for maneuver of national governments in a growing number of fields (but not all). This cannot but have political implications. As Martin Wolf points out in a recent article, globalization, in the form of freer commerce, undermines the collectivist values represented by the state to the benefit of the freedom of individual residents.(26) The erosion of these values will undermine the cohesion of nation-states as national identities: long understood as one of the justifications for mercantilist ideas.(27) In the face of domestic political forces that assert alternative claims of "identity," national governments face the difficult task of retaining and asserting enough sense of shared nationhood to maintain their underlying legitimacy while adjusting to a world in which the role of government in national states is becoming increasingly circumscribed.

One response is the idea of "competing nations," whereby governments recognize that it is companies, rather than they, which compete, but retain some influence in economic decisions: attracting mobile capital; raising the education level of the home population; ensuring financial stability; trying to improve the physical and cultural environment; creating a sense of civic "fairness."

But if the national responses of the "competing nations" are to be made compatible with international economic integration, there has to be supranational law and order. History has taught us that much of what we regard as the inexorable advance of globalization is, in fact, fragile and reversible. Without strong global (and regional) rules it can be rolled back.

There are currently global rules and institutions but they are not strong. The GATT (and its successor, the World Trade Organization) rests overwhelmingly on consent. Free trade has not so far proved easily enforceable. The International Monetary Fund has little influence over the economic policies of major governments even when their behavior affects other nation-states. Many international economic rules rest on informal understandings: the Bank of Settlements agreement on bank capital adequacy; the "gentlemen's agreement" on trade credit; the OECD code on investment and multinational corporations; the General Agreement to Borrow; ISO standards. Global economic governance--the cooperative structures within which nation-states have to operate in a globalized economy--hangs somewhat precariously by these threads of common understanding. If they snap, we could see the resurrection rather than the death of the nation-state.

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